Article

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“Intellectual Property lies at the centre of the modern company's economic success or failure”

Lester Thurow : Economist

Trade marks & Brands
Patents & Inventions
Copyright
Designs
Database rights
Data Protection
Licensing and Franchising
Intellectual Property agreements
New Media Agreements such as directors and authors rights
Transactional Intellectual Property

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Royalty Rates for Technology Transactions

by Deborah Niven
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We are often asked by clients what royalty rate they should negotiate in a licensing scenario, either by the licensee or licensor. An interesting study was carried out between 1990 and 2007 which discovered that the most frequently negotiated royalty rate is 5% of net sales.

We advise clients to take stock of the industry norms but surprisingly this study has shown that the 5% royalty rate appears to apply to a number of diverse industries including automotive, chemical, communications, computers, defence, energy, electronics, food, franchises, glass, household products, mechanical, medical, photography, sports, toys and waste treatment to name but a few.

There are various factors, which might affect the royalty rate such as exclusivity and value of the underlying technology. Another key consideration is the risk borne by each party in the relationship. For example if an inventor is licensing the IP to a business who intends to manufacture, supply and negotiate sales of the product then the risk involved for the inventor is far less than if he were to manufacture those products himself. Once IP protection is established, the inventor can effectively sit back and reap the rewards. For a product with a higher profit margin, the royalty rate is likely to be higher. Royalty rates above 15% exist but are more likely to be seen in extraordinarily profitable technologies such as those in the gaming and entertainment industries.

Other factors, which may influence the rate, are the nature of the intellectual property, the rights in the property, the level of incremental profits or cost savings through the use of the IPR, the strength of protection, exclusivity and competition. The nature of the definition of net can also be a bone of contention.

In competitive industries, licensees often fight for market share using price competition. When the price is reduced, a royalty based on a percentage of sales will yield lower royalty payments for licensors, so in some industries a “per unit” royalty may be agreed, taking the risk out of falling prices. The disadvantage of this is of course that if the price increases the licensor will not enjoy a higher return on the IP. However, research suggests that most arrangements are based on a percentage of net sales and licensors are usually willing to bear the differences in royalty payments where prices rise and fall.

Other structures might also be put in place, such as a one-off payment at the start of the licensing arrangement, a descending (or ascending) percentage when targets are achieved or no payment of fees or royalties, but rather an arrangement where other services or non-monetary payments are made.

For further advice on licensing and royalty rates please feel free to contact Virtuoso Legal.